



FINANCIAL INSTITUTIONS TODAY

News and topics of interest to financial institutions regulated by the Department of Banking and Finance

Monthly Bulletin #11

November 2011

Inside this issue:

The Control Environment... 2
(continued)

Annual Assessment for State-Chartered Financial Institutions 2

2012 NCUA Assessment Projections 2

Rule 80-1-5-.11: Combination of Debt for Legal Lending Limit Purposes 3

Georgia Residential Mortgage Act Fee Reminder 4

2012 State Holidays 5

Action on Applications for the Month of November 6

DBF Outreach and Upcoming Speaking Engagements 8

Contact Information 9

The Control Environment: Internal Controls and Verification (part 3 of a series)

"Boards of directors and audit committees are responsible for ensuring that their organizations have effective internal controls that are adequate for the nature and scope of their businesses and are subject to an effective audit process Supporting functions such as ... internal audit, ... credit review, compliance, and legal should independently monitor and test the control processes to ensure that they are effective." – Federal Reserve Governor Susan S. Bies (May 17, 2004)

In previous articles we discussed elements of the control environment as defined in a respected industry resource and regulation. This article describes common internal controls found in every financial institution, without regard to size or complexity, and introduces the roles of internal audit and independent loan review (also referred to as credit review) in promoting an effective control environment.

Two basic forms of internal control are segregation of duties and joint custody. The FDIC Risk Management Manual of Examination Policies (Exam Manual) describes segregation of duties as requiring the participation of two or more persons or departments in a transaction thereby causing the work of one to serve as proof of the accuracy of another. Duties should be arranged so that no one person dominates any transaction from inception to termination in order to diminish the likelihood of fraud or unidentified errors. Common examples of segregation of duties include designing the loan process so that the approving loan officer is not the same person disbursing loan proceeds, an individual authorized to sign official checks is not also reconciling correspondent bank accounts, source records are reconciled to the general ledger by someone other than the person originating general ledger entries, confirmation from the sale or purchase of investment securities are routed from the broker/dealer directly to a person without authority to conduct securities transactions, and the person taking wire transfer instructions from customers does not also have the authority to approve and transfer funds. The FDIC Exam Manual describes joint custody as charging two or more persons with equal accountability for the physical protection of certain items or records. Joint custody may involve maintaining two sets of keys or combinations, under the separate control of two different people, required to access vaults, files, or other storage devices. Common examples of joint custody include maintaining cash or check stock and other negotiable instruments in a secure location inaccessible by any one person. Internal controls are communicated through well defined policies and supporting procedures with the intent to safeguard financial institution assets and reputation, from neglect, fraud, or abuse.

(Continued on page 2)

The Control Environment: Internal Controls and Verification (part 3 of a series)

(Continued from page 1)

Internal audit and independent loan review functions provide reasonable assurance to boards of directors by validating that the financial institution's policies and supporting procedures contain controls that are reasonably designed to achieve the goal of safeguarding shareholder, customer, and member assets. In addition, internal audit and independent loan review verify that controls are being appropriately adhered to by financial institution personnel in the day-to-day course of their duties. Effective internal audit and independent loan review functions minimize the likelihood of unpleasant surprises and promote early identification of risks; thereby improving the capacity for management to take steps to reduce losses and implement timely corrective actions before they become a regulatory or legal issue.

Robust internal audit and independent loan review functions staffed by experienced, knowledgeable, well trained individuals (whether in-house or outsourced) provide an independent assessment and serve as the board of director's eyes and ears across an organization. They are an indispensable check and balance. Well designed, targeted reporting from these functions informs sound decision making by executives and boards of directors; thereby promoting healthy, successful financial institutions.

In the next article, we will begin to outline regulatory standards and expectations for the internal audit and independent loan review functions.

Annual Assessment for State-Chartered Financial Institutions

The annual assessment fee letters will be e-mailed to banks and credit unions early in December, and the fees will be assessed on **February 1, 2012**. Please complete and submit by December 31, 2011, the Electronic Funds Transfer Authorization/ACH Form for any change of information. The ACH Authorization and Instructions Form can be found on our website from the Banks & Holding Companies [Memos and Guidance page](#) or from the Credit Unions [Policy Statements and Guidance page](#). Please e-mail or call Renee` Martin with any questions at rmartin@dbf.state.ga.us or 770-986-1641.

2012 NCUA Assessment Projections

At the November 17, 2011 NCUA Board of Directors meeting, Board Chairman Debbie Matz announced that the NCUA would not collect an NCUSIF premium for 2011. The NCUA is reducing the projected NCUSIF premium to 0 – 6 basis points for 2012. The NCUSIF premium is based on variables that include insured share growth, investment income, insurance loss expense, and the NCUSIF equity level. The NCUA Board reaffirmed the projected range of 8 – 11 basis points for the 2012 Corporate Stabilization Fund assessment.

Credit union managers are reminded that these assessments are not due until the NCUA Board approves the actual assessment. If a credit union begins accruing for the 2012 assessments based upon the projected levels, the accrual should begin no earlier than January 2012. Credit unions should not accrue 2012 assessments in 2011. These accruals should be reported in Other Member Insurance Expense on the Call Report Statement of Income and Expense until the NCUA Board approves the actual assessment. The following link to the NCUA's Board Action Bulletin provides additional comments: <http://www.ncua.gov/about/Pages/Board%20Actions/BAB20111117.aspx>

Rule 80-1-5-.11: Combination of Debt for Legal Lending Limit Purposes (“common enterprise test”)

In conjunction with the Department’s proposed rulemaking that was issued for comment on July 13, 2009, subsequently adopted on August 17, 2009, and which became effective on September 7, 2009, Rule 80-1-5 was changed in order to clarify and modify the way in which loans to related entities are treated for legal lending limit purposes. Subsequent to this Rule change, requests for interpretations have frequently come from bankers and examiners regarding application of the “common enterprise test” element of the revised Rule. For clarification, the following is a brief summary of common enterprise that will result in loans being combined for legal lending limit purposes:

1. Each loan has the same expected source of repayment; or
2. Loans are to separate borrowers but meet thresholds for both common control¹ **and** substantial financial interdependence²; or
3. Separate borrower uses loan proceeds to acquire a business enterprise in which the borrowers will control more than 50% of the voting securities of the business enterprise after the transaction; or
4. The Department determines that a common enterprise exists based on an evaluation of the facts and circumstances of the individual transaction.

Most of the questions and requests for interpretation have centered on the second element of the common enterprise test which requires combination of loans to borrowers when both common control **and** substantial financial interdependence exist. The following examples illustrate application of the test:

Example 1: A borrower uses loan proceeds from the bank to acquire and renovate apartment buildings through a real estate holding company that she **controls**. A separate property management company that she also **controls** leases apartment buildings from the real estate holding company and uses a working capital line from the bank to finance its operations. **Substantial financial interdependence** exists between the two companies since more than 50% of the property management company’s gross expenses result from lease payments to the real estate holding company. Loans made to the two separate legal entities should be combined for legal lending limit purposes under the common enterprise test since common control **and** substantial financial interdependence exist.

Example 2: A bank provides working capital and fixed asset financing to a local building supply store. In addition, the bank provides construction loans to a local builder who purchases all of the building materials for his construction company from the local building supply store. Substantial financial interdependence exists in terms of gross expenditures since more than 50% of the construction company’s annual expenses are paid to the local building supply store for building materials. The local builder also owns 9% of the voting shares of the building supply store and serves on the store’s board of directors, but does not have the ability to elect a majority of its directors or have a controlling influence over the store’s management and policies. Loans from the bank to the building supply store and the builder should not be combined under the common enterprise test for legal lending limit purposes since there is no common control between these separate legal entities.

While elements one and two of the common enterprise test represent the most frequent circumstances requiring combination of debt for legal lending limit purposes, the fourth element listed above is a reminder that the Department may determine, relying upon specific facts and circumstances on a case-by-case basis, that a common enterprise exists as a result of the inherent risk of a borrowing relationship. For example, during the real estate boom, numerous banks across Georgia lent to construction and development companies formed as separate legal entities but characterized by common management, and frequently common ownership. While these borrowing relationships may not have triggered elements

(Continued on page 4)

Rule 80-1-5-.11: Combination of Debt for Legal Lending Limit Purposes (“common enterprise test”)

(Continued from page 3)

one or two of the common enterprise test at loan origination, as market conditions deteriorated, the inherent risk in these borrowing relationships quickly became apparent, materializing as a result of the separate legal entities’ lack of financial capacity to perform independently in a stressed market environment. Funds were frequently commingled and the bank often found itself dependent on a common source of repayment or guarantor. Given a similar set of facts and circumstances, the Department will evaluate various scenarios that may trigger dependence upon a common source of repayment and/or common control with substantial financial interdependence and may conclude that the debt should have been combined at time of origination for legal lending limit purposes.

¹ *Common Control exists if a borrower directly or indirectly controls the other borrower by:*

- 1) *25% or greater ownership of voting stock (10% threshold applies in limited circumstances),*
- 2) *Ability to elect a majority of directors, or*
- 3) *Controlling influence over management or policies.*

² *Substantial Financial Interdependence exists when 50% or more of one borrower’s gross receipts or expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts or expenditures may include gross revenues, expenses, intercompany loans, dividends, capital contributions, or other receipts or payments.*

Georgia Residential Mortgage Act Fee Reminder

The \$10.00 per loan fees required by O.C.G.A. Section 7-1-1011(b)(2) and Department Rule 80-5-1-.04 are due **no later than March 1, 2012**, for residential mortgage loans closed during the period July 1, 2011, through December 31, 2011. A \$10.00 fee will be due if the loan is a residential mortgage loan as defined in the Georgia Residential Mortgage Act (GRMA), and if a security deed, a modification of a security deed or other form of modification of a security interest is recorded.

Financial institutions, mortgage licensees and registrants that act as the *collecting agent* (including brokers who table fund and collect the fee) must submit the fees and file the fee statement before the deadline to avoid fines.

Per Department Rule 80-5-1-.04(b), GRMA per loan fee reporting / remittance must be completed on-line through the Department’s secure website. Reporting is required even if no residential mortgage loans were made and no fees are due. To avoid fines for failure to report / remit GRMA fees, reporting must be completed by the deadline noted above.

With the on-line payment process, the Department accepts either ACH drafts on a checking account or payments by Visa, MasterCard, AmericanExpress, or DiscoverCard credit cards. Reporting and fee payment must be done online from our secure website at: <https://bkqfin.dbf.state.ga.us/GRMAFee.html>.

2012 State Holidays

In accordance with O.C.G.A. § 1-4-1, Governor Nathan Deal proclaimed the following dates in 2012 as public and legal state holidays when the Capitol and all State agencies will be closed:

Holiday Name	Date Observed
New Years Day 2012	January 1st – Sunday Will be observed Monday, Jan 2 nd
Martin Luther King Jr.'s Birthday	January 16 th – Monday
Robert E. Lee's Birthday	January 19 th – Thursday Will be observed on Friday, November 23 rd
Washington's Birthday	February 20 th - Monday Will be observed on Monday, December 24 th
Confederate Memorial Day	April 26 th – Thursday Will be observed on Monday, April 23 rd
Memorial Day	May 28 th – Monday
Independence Day	July 4 th – Wednesday
Labor Day	September 3 rd – Monday
Columbus Day	October 8 th – Monday
Veterans' Day	November 12 th – Monday
Thanksgiving Day	November 22 nd – Thursday Lee's Birthday will be observed on Friday, November 23 rd
Christmas Day	December 25 th – Tuesday Washington's Birthday will be observed on Monday, Dec. 24 th



DBF Holiday Hours

The offices of the Department of Banking and Finance will be closed on Friday, December 23rd and Monday, December 26th in observance of State holidays. Our offices will also be closed on Monday, January 2nd for New Year's Day.

The Department wishes you and your family a wonderful Holiday Season!!

Action on Applications for the Month of November:

The following is a summary of official action taken on applications by State Financial Institutions under Chapter 7-1 of the Code of Georgia and petitions for Certificate of Incorporation of Financial Institutions and other matters of interest during the month of November 2011.

FINANCIAL INSTITUTION CONVERSIONS

<u>PREVIOUS NAME</u>	<u>CONVERTED TO</u>	<u>APPROVAL</u>	<u>EFFECTIVE</u>
DOCO Regional Federal Credit Union	DOCO Credit Union Albany Dougherty County	11-10-2011	
Fort Gordon Federal Credit Union	Fort Gordon and Community Credit Union Fort Gordon Richmond County	Pending	

APPLICATIONS TO ESTABLISH A BRANCH OFFICE

<u>FINANCIAL INSTITUTION</u>	<u>BRANCH OFFICE</u>	<u>APPROVAL</u>	<u>BEGIN BUSINESS</u>
Metro City Bank Doraville	Opelika Branch Office 1805 Gateway Drive Opelika, AL 36801 Lee County	11-10-2011	
Metro Bank Douglasville	Main Office 9340 The Landing Drive Douglasville, GA 30135 Douglas County	11-09-2011	
Ameris Bank Moultrie	One Atlantic Center Branch Office 1201 West Peachtree Street Suite 3100 Atlanta, GA 30309 Fulton County	11-30-2011	

FINANCIAL INSTITUTION MERGERS

<u>FINANCIAL INSTITUTION (SURVIVOR)</u>	<u>MERGED INSTITUTION</u>	<u>APPROVAL</u>	<u>EFFECTIVE</u>
Albany Federal Employees Credit Union Albany, GA	Members United Credit Union Columbus, GA	11-09-2011	
Georgia's Own Credit Union Atlanta, GA	The Thrift Credit Union Atlanta, GA	Pending	
Georgia Bank & Trust Company of Augusta Augusta, GA	Southern Bank & Trust Aiken, SC	Pending	
The Farmers Bank Forsyth, GA	The Bank of Perry Perry, GA	Pending	
The Farmers Bank Forsyth, GA	The Peoples Bank Covington, GA	Pending	

FINANCIAL INSTITUTION**(SURVIVOR)**

The Farmers Bank
Forsyth, GA

Glennville Bank
Glennville, GA

Bank of Upson
Thomaston, GA

Bank of Upson
Thomaston, GA

Bank of Upson
Thomaston, GA

MERGED INSTITUTION

Spivey State Bank
Swainsboro, GA

Tippins Bank
Claxton, GA

The First National Bank of Polk County
Cedartown, GA

Peachtree Bank
Maplesville, AL

Bank of Chickamauga
Chickamauga, GA

APPROVAL

Pending

Pending

Pending

Pending

Pending

EFFECTIVE

**APPLICATIONS TO BECOME A BANK HOLDING COMPANY
AND/OR TO ACQUIRE VOTING STOCK OF A FINANCIAL INSTITUTION**

FORMATIONS ONLY**BANK HOLDING COMPANY**

Sterne Agee Group, Inc.
Birmingham, AL

TO ACQUIRE

SUM Financial Corporation
Pearson, GA

APPROVAL

Pending

**NOTIFICATION OF APPROVAL OF APPLICATION
TO SERVE A RESIDENTIAL GROUP COMMON BOND**

CREDIT UNION

Central State Hospital Credit Union
Milledgeville

Georgia's Own Credit Union
Atlanta

RESIDENTIAL GROUP COMMON BOND

Baldwin County, GA

Walton County, GA

APPROVAL

11-09-2011

11-10-2011

CHECK CASHER LICENSES ISSUED

<u>CITY</u>	<u>APPLICANT NAME</u>	<u>TRADE NAME</u>
Madison	* BJR Enterprises, Inc.	Olde South Wine & Spirits
Columbus	Brianne Brooks	B & M Check Cashing
Winston	* Fair Mart, LLC	Fair Mart
Byromville	* Guru Kroopa, Inc.	Himm's Grocery
Athens	* HMV Sales, Inc.	Quick Pantry
Thomasville	* Jay Madi, Inc.	L&G Foodmart #1
Thomasville	* Jay Maledi Ma, Inc.	Granny's Country Store
Dallas	Lodhi 1 Food Mart LLC	Dallas Shell
Statham	* Mass Partners, LLC	On the Go Texaco
Atlanta	Mehreen Nawar, LLC	Affordable Check Cashing
Jackson	* Nikey LLC	Chevron Food Mart
LaGrange	* Second Chance Rehabilitation Services LLC	
Savannah	* Shil Nick, Inc.	Dollar Depot
Folkston	* Shree Ranchhod Rai, Inc.	OM Food Mart

* =Registered (O.C.G.A. 7-1-700 et al)

MONEY TRANSMITTER LICENSES ISSUED

<u>MONEY TRANSMITTER</u>	<u>APPROVAL</u>
Prabhu Group Inc. Jackson Heights, NY	11-09-2011
Century Union Services, LLC Lowell, MA	11-14-2011

DBF Outreach

AND UPCOMING SPEAKING ENGAGEMENTS

- ❖ Commissioner Braswell will be part of a regulatory panel at the GBA Credit Conference held December 8th at the Renaissance Waverly Hotel, Atlanta, GA..

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We're on the Web!

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dbf.georgia.gov**

The Department is the state agency that regulates and examines banks, credit unions, and trust companies chartered by the State of Georgia. The Department also has regulatory and/or licensing authority over mortgage brokers/processors, lenders and loan originators, money service businesses, international banking organizations, and bank holding companies conducting business in Georgia.

Our **Mission** is to promote safe, sound, competitive financial services in Georgia through innovative, responsive regulation and supervision.

Our **Vision** is to be the best financial services industry regulator in the country – Progressive. Proactive. Service-Oriented.

Our Motto is: "Safeguarding Georgia's Financial Services"

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